

## § 1.514(e)-1

gross income of the organization as unrelated debt-financed income.

(b) The application of this section may be illustrated by the following example:

*Example.* On July 1, 1970, T, an exempt trust, exchanges \$15,000 of borrowed funds for 50 percent of the shares of M Corporation's stock. M uses \$35,000 of borrowed funds in acquiring depreciable assets which are not used at any time for purposes described in section 514(b)(1) (A), (B), (C), or (D). On July 1, 1978, and for the 12-month period preceding this date, T's acquisition indebtedness with respect to M's stock has been \$3,000. On this date, there is a complete liquidation of M Corporation to which section 331(a)(1) applies. In the liquidation T receives a distribution in kind of depreciable assets and assumes \$7,000 of M's indebtedness which remains unpaid with respect to the depreciable assets. On this date, M's adjusted basis of these depreciable assets is \$9,000, and such assets have a fair market value of \$47,000. M recognizes gain of \$6,000 with respect to this liquidation pursuant to sections 1245 and 1250. T realizes a gain of \$25,000 (the difference between the excess of fair market value of the property received over the indebtedness assumed, \$40,000 (\$47,000-\$7,000) and T's basis in M's stock, \$15,000). A portion of this gain is to be treated as unrelated debt-financed income. This amount is determined by multiplying T's gain of \$25,000 by the debt/basis percentage. The debt/basis percentage is 20 percent, the ratio which the average acquisition indebtedness (\$3,000) is of the average adjusted basis (\$15,000). Thus, \$5,000 (20 percent of \$25,000) is unrelated debt-financed income. This amount and the gain recognized pursuant to sections 1245 and 1250 are added to M's basis to determine T's basis in the property received. Consequently, T's basis in the property received from M Corporation is \$20,000, determined as follows:

M Corporation's adjusted basis .....	\$9,000
Gain recognized by M Corporation on the distribution .....	6,000
Unrelated debt-financed income recognized by T with respect to the distribution .....	5,000
T's transferred basis .....	20,000

[T.D. 7229, 37 FR 28153, Dec. 21, 1972]

## § 1.514(e)-1 Allocation rules.

Where only a portion of property is debt-financed property, proper allocation of the basis, indebtedness, income, and deductions with respect to such property must be made to determine the amount of income or gain derived from such property which is to be treated as unrelated debt-financed income. See examples 2 and 3 of para-

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graph (b)(1)(iii) of § 1.514(b)-1 and examples 1, (2), and (3) of paragraph (b)(3)(iii) of § 1.514(b)-1 for illustrations of proper allocation.

[T.D. 7229, 37 FR 28153, Dec. 21, 1972]

## § 1.514(f)-1 Definition of business lease.

(a) *In general.* The term *business lease* means any lease, with certain exceptions discussed in paragraph (c) of this section, for a term of more than 5 years of real property by an organization subject to section 511 (or by a partnership of which it is a member) if at the close of the organization's taxable year there is a business lease indebtedness as defined in section 514(g) and § 1.514(g)-1 with respect to such property. For the purpose of this section the term *real property* and the term *premises* include personal property of the lessor tax-exempt organization leased by it to a lessee of its real estate if the lease of such personal property is made under, or in connection with, the lease of such real estate. For amounts of business lease rents and deductions to be included in computing unrelated business taxable income for taxable years beginning before January 1, 1970, see § 1.514(a)-2.

(b) *Special rules.* (1) In computing the term of the lease, the period for which a lease may be renewed or extended by reason of an option contained therein shall be considered as part of the term. For example, a 3-year lease with an option for renewal for another such period is considered a lease for a term of 6 years. Another example is the case of a 1-year lease with option of renewal for another such term, where the parties at the end of each year renew the arrangement. In this case, during the fifth year (but not during the first 4 years), the lease falls within the 5-year rule, since the lease then involves 5 years and there is an option for the sixth year. In determining the term of the lease, an option for renewal of the lease is taken into account whether or not the exercise of the option depends upon conditions or contingencies.

(2) If the property is acquired subject to a lease, the term of such lease shall be considered to begin on the date of such acquisition. For example, if an exempt organization purchases, in whole